



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

FRATERNAL INSURANCE IN THE UNITED STATES: ITS ORIGIN, DEVELOPMENT, CHARACTER AND EXISTING STATUS

BY WALTER S. NICHOLS,

Editor of the *Insurance Monitor* and *Insurance Law Journal*.

The origin of fraternal insurance must be sought in those social and communal instincts of the human family which from remote ages have led its members to coöperate for their common welfare. Fraternal organizations of one kind or another for mutual assistance have existed in the various countries from time immemorial. Under the old Roman Empire such societies were so numerous as to call for regulation by the state. During medieval times we find them in large numbers in the form of organized guilds for social, religious, and commercial purposes throughout the different countries of Western Europe. Those of England were the forerunners of the numerous friendly societies which succeeded them and whose special purpose was the relief of their members in case of sickness and the provision of a burial fund in case of death, to which was sometimes added a pension on attaining a certain age. It was from these British friendly societies that the idea of fraternal insurance was introduced into the United States at a comparatively early date in our history. But until after the middle of the last century no well directed effort was made to regulate their management in Great Britain. They were usually organized on fallacious principles. Contributions were exacted of the members regardless of age or condition of health and with no intelligent conception of the cost of the benefits which they promised. As a consequence their failures were so numerous as to become a national scandal, until their proper regulation was undertaken by the British Parliament which resulted in a thorough investigation by actuarial experts and a scientific determination of the principles on which the business must be conducted, and the rates which must be charged to secure its safety. Not until 1875 was legislation procured which placed the system of friendly societies in Great Britian on a comparatively sound foundation. The social affiliation between the

members of these British societies, however, was in many cases so strong as to hold their membership together in spite of their technical insolvency until the necessary corrective measures could be applied. In fact such social affiliations are the fundamental basis on which the successful operations of a genuine friendly society must rest.

The development of friendly societies—more commonly known as fraternal insurance societies—in America took a somewhat more radical form than in Great Britain. With the exception of a few, like the Free Masons and the Odd Fellows, they generally attached less emphasis to the social features and more to the insurance feature. The majority of them have directed their chief work to granting death benefits. Sick benefits, when allowed, are usually cared for by subordinate local lodges.

The development of fraternal insurance in the United States has been largely shaped by the same social and economic influences which have controlled the development of ordinary life insurance. So-called fraternal societies have been largely utilized in the past for the purpose of furnishing a supposedly cheap form of life insurance with too little regard for the benevolent features which are so essential to its success. The same social and economic conditions which caused the remarkable development of life insurance in the United States during the last half century resulted in the great growth of fraternal and benevolent associations. The rapid growth of cities and the change from an agricultural to an industrial population were largely responsible for the more recent remarkable development both of life insurance and its allied forms of benevolent societies. The growth of the latter was attended with the same disregard of sound insurance principles and ignorance of the actual cost of the promised benefits as in Great Britain. The results were even more disastrous. The spirit of conservatism which controlled the expansion of life insurance in Great Britain was lacking in America. The work of the associations instead of being localized within the limited area of a small island was often expanded over a wide territory.

The great expansion of life insurance which took place after 1860 was attended by a corresponding development of fraternal and so-called benevolent societies which simply aimed to provide a cheaper form of insurance than was furnished by the regular com-

panies. These associations sprang up in great numbers in the years following the sixth decade of the last century. The ordinary business corporations had already been subjected to legal restrictions designed to secure their solvency and proper management, but fraternal benefit associations, being presumptively of a benevolent character, were not subjected to such restraints. The consequence was that, in addition to the genuine fraternal societies, another class of associations grew up claiming to be fraternal in their character and conducted on similar lines but usually having no lodge system like the true fraternal and none of the social features. Such associations were in effect disguised life insurance companies, carried on like them for profit and seeking to compete with the regular companies by selling life insurance at rates much lower than those which the regular companies were forced to charge. This they were able to do because they were not compelled to put up the legal reserve required of the regular companies. Their contracts in consequence could not be carried out. Their numerous ultimate failures became a notorious scandal. They were popularly known as coöperatives or assessment companies, and it was not always easy to distinguish them from the genuine fraternal societies which they sought to imitate. Both of these classes of institutions, like the British friendly societies, were conducted on a scale of rates that was wholly inadequate and which at first usually took the form of assessments collected from the members to pay death claims as they occurred. They were conducted for the most part like the British societies in ignorance of the true principles of insurance.

The probability of death and the consequent cost of insurance increase with age. It is therefore necessary for the insured person either to pay a premium increasing with his age or, if he is to pay a uniform level premium, it must be excessive at the start in order to create a fund in the hands of the company from which to make good the deficiency in later years. This vital feature was ignored by the fraternal and assessment orders until bitter experience compelled its recognition. They saw the ordinary life companies, which were for the most part also young, charging premiums which were enormously in excess of their current death losses and accumulating year after year a constantly increasing reserve fund while their loss rate itself showed no apparent increase. They jumped to the conclusion that the reserve fund was a needless exaction

from the policyholders and that they could grant insurances at the current loss rates of the regular companies. They could not be made to see that the companies were still new and their business increasing at a rate which kept their average membership young notwithstanding the increasing age of individual members. The heavy lapse rates of the policies, too, by weeding out the older membership, helped the delusion. That neither the average age of the membership nor the average death rates of the regular companies sensibly increased as the years went on was a favorite argument of the benevolent orders in defense of their inadequate rates and a strong weapon in their competition for business.

Another favorite argument was the condition of the ordinary town and village community whose average ages remained the same while the individual members were continually growing older. The births equalled the deaths and so preserved the average. So the constant new additions to their membership would keep down their average age. Again they could not be made to understand that, unlike the town community, their members all started young together and their average ages were bound to increase until an equilibrium was reached dependent on the relative rates at which new members were secured and the older members were retired through lapses and deaths. Before this equilibrium age could be attained the societies had already begun to feel the stress of their increasing death losses, and their members had begun to change their membership to newer societies which could furnish cheaper insurance. Years would often elapse before this stage was reached if the membership increased at a rate sufficiently rapid. Meanwhile the society would go on in the blind belief that all was well until the increasing death rate gave warning that their rates must be increased. The attempt to do this was sure to create dissatisfaction which resulted in an increased loss of membership and a diminished supply of new members, thus enhancing the trouble which they were seeking to escape. The process of dissolution thus started gathered momentum as it continued. The expedients resorted to to make good this growing deficiency, either by increasing the rates or reducing the benefits, were generally temporary compromises which merely relieved the situation for the time, until the growing deficiency again called for a new adjustment and created a fresh loss of membership. The end came when the burden of carrying the old members could

no longer be met by rates which had grown too heavy to be borne, and members could no longer be secured with the fact staring them in the face that they would be compelled to make good from their own contributions the deficiencies in the past payments of these older members. The ultimate disintegration of the society would follow, leaving its members without the protection which they had perhaps been contributing for years to secure.

Such has been the sad history of large numbers of these societies in the past, due to their refusal to recognize until too late the necessity of an adequate reserve to meet the increasing death losses of advancing age, and to their attempt to furnish cheap insurance at inadequate rates on the basis of its current cost. In one important respect the claims of fraternal insurance to be less costly is correct. In the genuine fraternal orders, with their systems of subordinate lodges through which their agency work is carried on, expenses necessarily involved in the agency system of the ordinary business corporations are largely avoided. The members themselves act as agents of the society. The societies, on the other hand, lose the advantages of the interest earnings on those large invested funds of the ordinary companies that so materially reduce the actual cost of their insurances. Strenuous efforts were made during the latter part of the last century to correct these defects of the system, especially by the insurance departments of the various states through legislative regulation. But such efforts were frustrated for a long time through the opposition of the members themselves, whose political influence was strong and many of whom looked on such legislation as an attempt by the regular companies to break up the system. This opposition gradually weakened as the increasing age of the societies compelled them in greater numbers to realize the imperative necessity of readjusting their rates on a sound scientific basis. At last the time became ripe for radical action and a convention of the insurance commissioners in the various states undertook to frame a bill which would compel these associations to gradually increase their rates and accumulate a reserve which would place them on a basis actuarially sound and would subject them like the regular companies to the supervision of the various insurance departments of the states. Such a bill, known as the Mobile Bill, was adopted by a convention of the commissioners meeting in that city in 1910, and was recommended for passage to the various state

legislatures. It of course encountered strong opposition, especially on the part of societies that felt that their deficiencies had grown too great to comply with its requirement, and that they would be forced to close. But the principles of the bill have gradually been adopted until now it has become a law in thirteen of the states. The effect has been that not only the societies belonging to those states but the larger societies, even though located elsewhere but which were doing business in such states, were forced into compliance.

Before this crucial step had been taken by the commissioners, the better class of fraternal societies had already realized the necessity of a radical change in the system and had organized a Fraternal Congress in 1886 composed of some forty of their leading organizations. This Congress collected the experience of its members and framed a mortality table showing the actual death rate among them, and in other ways sought to bring about the needed reforms. One great difficulty, however, in the application of such a table was the wide diversity of the classes from which the members of these societies were drawn as well as their diverse financial conditions, both of which seriously affected the death rate which must be expected.

Under the Mobile Law a definite period is allowed during which the society must gradually build up an adequate reserve which, like that of the old line companies, will make good deficiencies in their rates, and place them on a similar basis of commercial solvency. The changes in the system exacted by this law are still in process of being effected and it is too soon to state with certainty the outcome. The very recent experience of the Royal Arcanum, one of the largest of these societies, will illustrate its operation.

This society was organized in 1877 in Massachusetts and embraces in its membership the best representatives of the fraternal orders. Its subordinate councils are scattered throughout all the more healthful states and territories. After twenty years of rapid growth, it at last reached the stage where radical reform in its system was imperative. Its old post mortem system of assessments at death was discarded for definite annual payments of largely increased amount and the creation of a large emergency fund. After fifteen years' experience under its revised plan it finds itself unable to meet the requirements of the Mobile Law and is compelled

to again practically double its rates in order that the requisite reserve shall be secured within the allotted time, which expires in 1920. Of its two hundred and forty thousand members, it is estimated that from sixty to a hundred thousand may resign from the order through the dissatisfaction which had been created. The hardships and disappointments involved in these resignations will be great. But the crisis once successfully passed, it is not unreasonable to anticipate that the society may start on a new upward career, and on a foundation that will thereafter assure its members of the ultimate payment of all its obligations without future changes in its rates or modifications of its plan.

The great multiplication of friendly societies in the country practically began at the close of the Civil War. Until about 1888 no serious attempt at their regulation by legislation was made. They were regarded simply as charitable organizations. Neither the legislatures nor the courts were able to distinguish between their fraternal and their business features. Even today some of the courts and legislatures still incline to the view that they do not undertake to furnish indemnity and are therefore merely charitable in their nature. But the prevailing more advanced views regard them as business corporations obligated like all others to strictly carry out their contracts, irrespective of their financial ability.

The first practical legislation, aimed at their regulation, was adopted by the states of Massachusetts and New York in 1888 upon the initiation of representatives of the societies themselves. The Fraternal Congress, representing the best class of these societies, soon after framed a uniform bill for their regulation, which after several years of discussion was adopted by several of the states in 1893. From this time until 1910 there was friction between the Congress and the insurance commissioners over amendments to the bill which lacked the elements necessary properly to safeguard the business. The efforts of the Congress, imperfect as they were, to place it on a securer foundation, were resisted by a confederation of the weaker societies, known as the Associated Fraternities, who opposed any governmental interference. Because of this opposition no successful effort to improve the societies' uniform bill could be made and at last the commissioners determined to draft their own measure which resulted, as has been said, in their framing the Mobile Bill as a joint measure whose passage they could recommend to their

several states. Meanwhile since 1895 the societies' bill has been adopted by some twenty states.

In 1895 the better class of the fraternalists began a voluntary readjustment of their rates which soon became the order of the day and which was supplemented by framing the Fraternal Congress mortality table. These reforms, however, were, as has been said, of a compromise character affording a mere temporary relief. The aim still was to avoid the accumulation of an adequate reserve and to meet their deficiencies by emergency funds supplemented by moderate increases in their rates. They depended on their lapses and new membership to do the rest. The adoption of the Mobile Bill was at first strongly opposed by the fraternal orders and even by some of the commissioners themselves as too radical a measure with which it would be impossible for the societies to comply without a loss of membership that would be destructive. Another serious barrier to the proper increase of rates was the tendency of the courts to treat the undertakings of the societies with their members as contracts giving vested rights to the latter and confining any rate increase to new members, thus throwing upon the latter the burden of making good the deficiencies.

A most important decision on this point has just been rendered by the United States Supreme Court in the case of *Supreme Lodge v. Mims*.¹ It is held that where a fraternal society has the power to alter its contributions at will it may increase its rates notwithstanding a provision in its laws that monthly payments of its members shall continue the same during their membership. This provision is not to be regarded as a contract but merely as a regulation subject to the possibility that an increase of rates may be necessary in order to pay its benefits. What is more, in this case the provision as to payment allowed the society as an alternative, if the assessments were inadequate, to reduce the payment accordingly. Nevertheless, the court declared that adequate payments were essential to the life of the corporation and it was entitled to fall back upon its general charter right to amend its laws in order to overcome a provision in the laws that the assessments should not be increased. It was not compelled to resort to the alternative of reducing the

¹*Insurance Law Journal*, p. 255. To the same effect is the case of *Holt v. Supreme Lodge*, U. S. Circuit Court of Appeals, Seventh Circuit, *Insurance Law Journal*, January, 1917.

benefit. The society was of the nature of a club which, notwithstanding a stipulation in the laws to the contrary at the time of a member joining, might under its chartered right increase its rates to a figure required to meet the benefits essential to the satisfactory performance of its mission.

This radical departure from the previous prevailing disposition of the courts to treat such limitations of assessments as vested contract rights promises to remove one of the great hindrances in the way of increasing the rates of old members to an adequate figure in order to comply with the requirements of the Mobile Law. If the doctrine here laid down by the highest court in the land is accepted by the various state courts, the most serious obstacle to the correction of their rates by the fraternal orders will be removed. As the members of the societies have become more enlightened regarding the character and requirements of their business, the opposition to their proper regulation has gradually diminished. In 1914 the Associated Fraternities united with the Fraternal Congress, and the joint organization gave its support to the efforts of the commissioners to secure adequate government regulation, which was still opposed, however, by a third reactionary organization of the weaker societies known as the Federated Fraternities. Such progress in the work of reform had been made by that year that the Mobile Law had already been adopted by eleven states, and its amended form, known as the New York Conference Bill, by seventeen.

The leading features of the latter, as expressed in the Insurance Law of New York, will show the nature of the requirements now made to insure the ultimate soundness of fraternal societies. The fraternal society is defined as an organization conducted without profit solely for the benefit of its members under the lodge system and a representative form of government and paying death or disability benefits. It must have a supreme lodge as a governing body made up of representatives of the various local lodges whose members are admitted by prescribed rules and which hold meetings at least monthly. It may issue benefit certificates for a term of years as well as for life but may not promise endowments except under certain conditions. If its rates have been properly readjusted, the society may accept half the payments in cash and charge the balance with compound interest against the certificate. Only certain specified relations may be made beneficiaries and they can take no

vested interest. The members may change the beneficiary at will. Nor can any beneficiary pay the contributions required of the member. The constitution and laws of the society with the member's application constitute the contract of the member and the former is subject to change. The society may maintain an emergency fund but no individual member shall be entitled to any specific share except under certain conditions. If the society is found to be maintaining a 4 per cent reserve by the American table, it may grant extended and paid-up insurances and withdrawal equities not exceeding the reserve. Endowment benefits, and benefits payable at seventy, may also be granted. Certificates must be issued to the members specifying the amount of benefit and stating that it, together with the constitution, laws and application, form the contract. The society's laws must state the specific object of the payments and what portion can be used for expenses. The mortuary fund may not be used for this purpose. The Fraternal Table at 4 per cent shall be a minimum standard of valuation except where the society has its own experience framed from at least twenty thousand lives. If at the valuation at the close of 1917 the company shows a deficiency and such deficiency shows an increase in the triennial valuation of 1920, new members must be placed in a separate class at adequate rates and the Superintendent of Insurance, if he deems it best, may institute proceedings to wind up the society. In lieu of this requirement, however, the society may provide in its by-laws for increasing the contributions of the members if their share of the annual losses is in excess of their annual payments. The Mobile Bill requires also that if in 1917 the assets are less than 90 per cent of the liabilities the deficiency must be decreased at least 5 per cent during the succeeding three years.

Such are the leading features of the most advanced legislation on this subject. It ranges from this high standard to practically no effective legislation in some of the states. It is obvious that a compliance with this standard will tend to assimilate the fraternal society more nearly in its character with the ordinary life company. A similar system of invested reserves, though perhaps smaller in amount, will be exacted. Instead of assessments having little regard to the actual cost of insurance, they will approximate such cost. Contributions for expenses can no longer be applied to the payments of benefits, nor the reverse. Whatever advantages may be de-

rived from the social features and the agency work of the members themselves, will remain, but these will naturally be diminished as the cost of membership increases and the society approaches the form of a business organization. The expenses of procuring new members will naturally increase through the employment of paid solicitors. But what is most important, the promised benefits will be more definite in their character and the assurance of their ultimate payment will be greater. There will be the stronger need for those social relations of the lodge system which must always be at the foundation of genuine fraternal orders. What will be the ultimate issue, it is too soon perhaps to predict. But the tenacity with which the system has been perpetuated in spite of its defects gives strong assurance that the better societies will be able to reorganize on a basis which will be permanent. The losses due to their failures heretofore have been more in the shape of disappointed expectations than in actual wastage of funds. They have furnished temporary insurance to their members at a minimum of cost, though often unable to pay the promised benefits to the long livers on account of their insufficient rates. A more intelligent and honest class of men have succeeded to their management and their members are being educated up to the requirements of their work.

In the face of its defective character, fraternal insurance has been steadily growing in its membership and in its beneficence. In 1896 the societies forming the national Fraternal Congress, which included the great body of the true fraternal orders in the country but excluded the mere assessment orders which maintained no genuine lodge system, had a combined membership of over a million and a half and benefit certificates in force of over three billion dollars. They had paid out in benefits more than twenty-eight million dollars during that single year, and over two hundred and thirty millions during the previous ten years. Nineteen years later the strictly fraternal orders doing business in New York which embraced the principal societies of this country reported a membership of over five millions and certificates in force of over six billion dollars. But as against their enormous future payments promised in their certificates they held assets of only about one hundred and forty-six millions, or little more than one dollar in fifty. The regular life companies doing business in that state in the same year had between seven and eight hundred thousand policies in force, insuring over

fourteen billion dollars, against which they held assets of between four and five billions or about fourteen dollars in fifty. In other words the regular life companies were required by law to carry about fourteen times the amount of funds of the fraternal orders in order to maintain their technical solvency. The comparison of these figures shows the threatened future deficiencies of the fraternal orders which the recent legislation is seeking to correct. It is obvious that no scheme of assessments, if deferred until these enormous obligations become due, can make good the deficiencies, and the legislation is aimed to compel an adequate reserve while there is yet time for its creation.

Roughly speaking about five-twelfths of all the lives insured in the United States, aside from industrial insurance, are carried in fraternal societies, the remaining seven-twelfths being in the regular companies. The industrial companies, however, have more than double the membership of all the others combined, though the amount insured is less than that of the fraternal orders. The mere assessment companies doing business for profit have been largely weeded out during more recent years either through failure or through more or less successful changes in their systems to conform to that of the old line companies. The genuine fraternal society is in its nature a social club for the mutual aid of its members as well as an insurance organization. Its character as a club has been generally recognized by the courts. A society is made up of local lodges whose representatives combine to form the grand lodge which is the governing body of the whole. Each local lodge is the social and business center of its members. It collects the dues and assessments and independently cares for the sick and disability benefits of its own members. The death benefits are cared for by the grand lodge. The dues and initiation fees when exacted are used to meet the expenses of the society. The benefits are met from the assessments or contributions for that purpose by the members. They are essentially coöperative bodies having no capital and yielding no profit. Their promised benefits are not in the nature of legal indemnities and cannot be used as collateral securities or be attacked by creditors. The agreement between the society and its members is not a policy or business contract as in commercial life insurance, but is embraced in a certificate of membership in which the member agrees to comply with the laws and regulations of the society then

or thereafter in force. This general agreement is supplemented by the statements in his application. The benefits themselves are prescribed by the laws of the society and the claim of the member is by virtue of his membership. He has no vested property rights in the society until the claim has actually matured. A beneficiary can be designated only within the prescribed relationships; such beneficiary takes no vested interest and may be changed by the member at will. In a word fraternal societies do not furnish commercial life insurance in the nature of an indemnity, but a fraternal assistance or relief.

The right of assessment in case of deficiencies, which they generally retain, technically relieves them from the charge of legal insolvency when unable to meet their claims, especially when the promised benefit is limited to the amount which the assessment may yield; but it does not relieve them from the practical effects of insolvency when such assessments fail to produce the amounts needed to meet the expected benefits. This technical loophole, however, has proved an important protection in the past against their legal adjudication as insolvents and against legislative interference. Their methods of assessing contributions differ widely, since they were forced to increase their rates and to recognize the effect of age on the cost of insurance. The earlier attempts were directed to create an insufficient emergency fund in place of a proper reserve while increasing their rates only according to some assumed current cost at the various ages; often, too, relying on lapses to make good deficiencies. Sometimes, where their laws permitted, the benefits were scaled. But this the courts refused to sanction unless it was clearly authorized. Sometimes a step rate plan was resorted to, the rates remaining level through a group of ages and being increased as the next succeeding group was reached. Sometimes the rates were fixed according to the age attained by the member, at others according to his age at entry, but the last required some adjustment of their past deficiencies in case of old members if the rates were to be made adequate.

The older the society the greater, of course, were the deficiencies and the more difficult it became to correct them, especially in view of the alleged rights of such members to exemption from increased rates. A compromise was sometimes attempted by permitting the member to continue his original rate upon giving a lien

on the promised benefit equal to the deficiency in the reserve. The more recent readjustments have generally been made on the basis of the age attained by the member with modifications of the rates, however, at those advanced ages where they would otherwise be prohibitory. Thus the societies are gradually being brought in line with those of Great Britain where an adequate level premium and reserve are maintained as in the ordinary life companies.

How many of the societies will succeed in reaching this standard will depend on the extent of the deficiencies to be made good, and the ability to secure new members at the increased rates. Opposition on the part of the members and heavy lapse rates at the start are to be anticipated. But past experience seems to indicate that in the end those societies which are able to stand the strain will emerge on a solid foundation for the future. Paid solicitors will be more needed to secure new members as the society approaches in its character the ordinary business company and the expenses of management will naturally increase, all of which emphasizes the importance of maintaining the social and fraternal features. It would be a great mistake to assume that their failures in the past represent corresponding moneyed losses to their members. Their moneys have been spent in fraternal insurance benefits. But these have been in the nature of term insurances except to the short lived. The loss has been the failure of the long lived to receive benefits which they had been promised but which their payments were insufficient to provide. In the face of all their past defects it has been estimated that they have collected and paid for the benefit of their deceased and sick members more than six hundred millions of dollars during the last forty years at a moderate cost of management. They continue to meet a want in the community which commercial life insurance can but imperfectly supply. The fraternal instinct is today as strong in the human breast as when the trade and religious guilds were dominant in Western Europe, and it is only reasonable to expect that the fraternal orders under more enlightened management will continue their beneficent mission.